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SUPREME COURT, U.S.
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No. 354

In the Supreme Court of the United States

OCTOBER TERM, 1960

MIDLAND FORD TRACTOR COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
HOWARD A. HEFFRON,
Acting Assistant Attorney General,
ROBERT N. ANDERSON,
MORTON K. ROTHSCHILD,
Attorneys,
Department of Justice, Washington 25, D.C.

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 316–328) are not officially reported. The opinion of the Court of Appeals (Pet. 1a–8a) is reported at 277 F. 2d 111.

JURISDICTION

The judgment of the Court of Appeals was entered on April 29, 1960. (Pet. 1.) A petition for rehearing was denied on June 13, 1960. (Pet. 2.) The petition for a writ of certiorari was filed on August 23, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the determination by the Tax Court of reasonable compensation for the taxpayer's officers was clearly erroneous.

STATUTE AND REGULATIONS INVOLVED

The pertinent portions of Section 23(a)(1)(A) of the Internal Revenue Code of 1939 and of Sections 29.23(a)–6 and 29.23(a)–8 of Treasury Regulations 111 are set forth in the Appendix, *infra*, pp. 9–11.

STATEMENT

The relevant facts as found by the Tax Court (R. 316–326) may be summarized as follows:

Midland Ford Tractor Company, hereinafter called the taxpayer, was incorporated in Missouri in June, 1947, and issued 250 shares of stock divided equally among John J. Graham, Louis Clay, Sr., and Tom W. Dutton. On or about August 15, 1948, Clay transferred to his son 33 shares. No further transfers were made prior to June 30, 1952. The taxable years involved are the fiscal years ended June 30, 1951, and June 30, 1952. (R. 316–317.)

The officers and directors of the taxpayer at all times involved were Graham, president, Clay, vice-president, and Dutton, secretary-treasurer. (R. 317.) The taxpayer's business consisted of distributing Ford tractors and equipment to dealers in eastern Missouri and southern Illinois. (R. 317.)

Although Graham, the taxpayer's president, devoted all of his time to the taxpayer's business, Clay and Dutton did not. (R. 322.) The salaries paid to each of the latter two officers of the taxpayer by five

other corporations during the taxable years aggregated more than $50,000. (R. 326.) The aggregate salaries for all three of the taxpayer's officers claimed as deductions on the taxpayer's income tax returns for the fiscal years 1948, 1949, and 1950 were $38,267, $55,500, and $55,500, respectively. (R. 325.)

In November, 1950, the taxpayer's accountant wrote a letter to Graham in which he indicated that in his opinion the Internal Revenue Service should consider a salary of $48,000 a year for Graham, a full time official, as reasonable and that salaries of $18,000 per year each for Clay and Dutton for their part time services could be justified. (R. 323–324.) About a week later, the taxpayer's directors held a meeting and passed a resolution fixing Graham's salary at $30,000 per year, and the salaries of Clay and Dutton at $18,000 each per year. In addition to their fixed salaries, the three officers were to receive, respectively, 12½%, 10%, and 10% of the net profits in excess of $100,000. (R. 324–325.) As the result of this resolution, the aggregate salaries claimed by the taxpayer as deductions for officers' compensation in 1951 and 1952 were $203,562 and $189,783, respectively. (R. 325.)

The dividends paid by the taxpayer in the fiscal year 1950 were $125,000; the dividends paid for each of the fiscal years 1951 and 1952 were $50,000. (R. 326.)

In the deficiency notice sent to the taxpayer, the Commissioner determined that the reasonable compensation for officers for the fiscal year 1951 did not exceed $62,735.62, and for the fiscal year 1952 did

not exceed $75,521.90. (R. 10–14.) The Tax Court, on petition for redetermination, determined reasonable compensation for the three officers for the fiscal years 1951 and 1952 to be $102,000 and $100,000, respectively (R. 326–328). The Court of Appeals affirmed the finding as not clearly erroneous. (Pet. 8a.)

ARGUMENT

The question as to what is a reasonable allowance for salary within the meaning of Section 23(a)(1)(A) of the Internal Revenue Code of 1939 and Sections 29.23(a)–6 and 29.23(a)–8 of Treasury Regulations 111 (Appendix, *infra*, pp. 9–11) is essentially a question of fact. The amounts fixed by the Tax Court and approved by the court below are within the range of the evidence. The aggregate amount of salaries paid the taxpayer's officers for the fiscal year 1948 was about $38,000 and for each fiscal year 1949 and 1950 about $55,000; for the fiscal year 1951, the first of the two taxable years, the aggregate amount of salaries jumped to about $203,000, and for the fiscal year 1952 it was about $189,000. (R. 325.) While the Commissioner determined that about $62,700 was a reasonable allowance for officers' salaries for the fiscal year ended in 1951 (R. 13), and about $75,000 for the fiscal year ended in 1952 (R. 14), the Tax Court increased these amounts to $102,000 and $100,000, respectively (R. 326, 328). Between the fiscal years 1950 and 1951, when the salaries were increased from about $55,000 to about $203,000, the net sales of the taxpayer increased only about 15%—from about

$7,203,000 to about $8,272,000. (R. 325.) Just prior to the passage of the resolution by the taxpayer's directors increasing the officers' salaries, the taxpayer's accountant indicated in a letter to the taxpayer's president that in his opinion a salary of $48,000 for Graham and a salary of $18,000 each for Clay and Dutton, or a total amount of $84,000, would be considered reasonable by the Internal Revenue Service. (R. 323–324.) The record shows that the aggregate amount of salaries paid to three officers of a corporation engaged in a business similar to that of the taxpayer in St. Louis was about $41,400 and $48,700 respectively, for fiscal years ending in 1951 and 1952. (Resp. Ex. 11;[1] R. 291, 295–297, 301, 317.)

Graham, Dutton, and Clay (together with his son, to whom he transferred part of his stock) owned in equal shares all of the taxpayer's stock during the taxable years. (R. 316–317.) While the taxpayer's officers' total salaries increased from $55,000 in the fiscal year 1950 to $203,000 in the fiscal year 1951 (R. 325), the dividends decreased from $125,000 to $50,000 (R. 326). The taxpayer failed to introduce any evidence of salaries paid by other corporations engaged in a similar business at about the same time in excess of those allowed by the Tax Court. The court below decided that there was substantial evidence to sustain the finding of the Tax Court with respect to a reasonable allowance for

[1] Pursuant to stipulation (R. 337), the exhibits were not included in the printed record. The cited exhibit is being transmitted to this Court by the Clerk of the Tax Court.

officers' salaries, and hence that the Tax Court's decision was not clearly erroneous. (Pet. 8a.) The concurrent findings of the Tax Court and the Court of Appeals are entitled to finality and present no question appropriate for review here. Cf. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51; *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

The taxpayer alleges that the statement of the court below that the Tax Court was not bound to believe the testimony of any particular witness even though not directly contradicted, is in conflict with many decisions. (Pet. 7–12.) But none of the cases cited involves facts similar to those in this case, where the taxpayer's auditor indicated that about $84,000 would represent reasonable compensation for the taxpayer's officers (R. 323–324), and where the Commissioner introduced evidence showing that the salaries paid by a corporation engaged in a similar business in the same city were less than half the amount allowed by the Tax Court (Resp. Ex. II; Pet. 7a–8a). As stated by the court below (Pet. 8a), in view of the evidence in this record, it cannot reasonably be considered that the evidence produced by the taxpayer was uncontradicted.

The holding of the court below, that the trial court was the exclusive judge of the credibility of the witnesses and the weight to be given to their testimony (Pet. 8a), is in accordance with the principles laid down by this Court in *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282, 294; *Dayton P. & L. Co.* v. *Public Utilities Commission*, 292 U.S. 290, 299; *Darcy* v. *Handy*, 351 U.S. 454, 465.

CONCLUSION

The decision of the court below is correct and there is no direct conflict of decisions. The case depends upon its own particular facts and is of no general importance. The petition for a writ of certiorari should be denied.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.

HOWARD A. HEFFRON,
Acting Assistant Attorney General.

ROBERT N. ANDERSON,
MORTON K. ROTHSCHILD,
Attorneys.

SEPTEMBER, 1960.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—
>
> (1) *Trade or business expenses.*—
>
> (A) *In General.*—All the ordinary and and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *.

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> SEC. 29.23(a)-6. *Compensation for Personal Services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:
>
> (1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (a) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw

salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. * * *.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

SEC. 29.23(a)–8. *Bonuses to Employees.*—Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income.

Sections 39.23(a)–6 and 39.23(a)–8 of Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939, effective January 1, 1952, are substantially the same as the sections set forth above.

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